

**Letter of Findings Number: 06-0310
Adjusted Gross Income Tax
For the Tax Period 2002-2004**

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ISSUES

I. Adjusted Gross Income Tax – Unitary Status

Authority: IC § 6-8.1-5-1(b); IC § 6-3-2-1; [45 IAC 3.1-1-153](#).

The Taxpayer protests the disallowance of unitary status.

II. Tax Administration- Ten Percent Negligence Penalty

Authority: [IC 6-8.1-10-2.1](#), [45 IAC 15-11-2](#) (b)(c).

The taxpayer protests the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

The Taxpayer is an Indiana corporation. Pursuant to an audit, the Indiana Department of Revenue (Department) assessed additional adjusted gross income tax, interest, and penalty for the years 2002-2003. The Taxpayer protested and a hearing was held. This Letter of Findings results.

I. Adjusted Gross Income Tax- Unitary Status

DISCUSSION

The Taxpayer purchased a 99 percent interest in a Florida limited partnership on April 20, 2001. The remaining one percent interest in the partnership was owned by the general partner, a foreign parent corporation. The partnership's operation provided logistics services to customers. The partnership usually delivered product by airplane, but did use other methods of transportation on occasion. During the tax period, the Taxpayer filed consolidated income tax returns with its subsidiaries that had Indiana nexus. In 2002, the Taxpayer considered the partnership's operations as unitary with its operations. Therefore, the Taxpayer included 99 percent of the partnership's tax factors in its consolidated 2002 Indiana adjusted gross income tax return. The Department denied the unitary status and adjusted the Taxpayer's liability accordingly. The Taxpayer protested the denial of the unitary status and resulting assessment of tax.

All tax assessments are presumed to be valid. IC § 6-8.1-5-1(b). The Taxpayer bears the burden of proving that any assessment is incorrect. *Id.*

Indiana imposes a corporate adjusted gross income tax "on that part of the adjusted gross income derived from sources within Indiana of every corporation." IC § 6-3-2-1(b).

The Indiana Adjusted Gross Income Tax Regulations clarify the application of the adjusted gross income tax to corporate partners at [45 IAC 3.1-1-153](#) as follows:

(a) A corporate partner's share of profit or loss from a partnership will be included in its federal taxable income and therefore generally subject to the same rules as any other adjusted gross income.

(b) If the corporate partner's activities and the partnership's activities constitute a unitary business under established standards, disregarding ownership requirements, the business income of the unitary business attributable to Indiana shall be determined by a three (3) factor formula consisting of property, payroll, and sales of the corporate partner and its share of the partnership's factors for any partnership year ending within or with the corporate partner's income year,...

(c) If the corporate partner's activities and the partnership's activities do not constitute a unitary business under established standards, disregarding ownership requirements, the corporate partner's share of the partnership income attributable to Indiana shall be determined as follow:....

(2) If the partnership derives business income from sources entirely within Indiana, or entirely without Indiana, such income shall not be subject to formula apportionment.

The Regulations make it clear, that the income from a partnership is treated differently if it is a unitary operation or a non - unitary operation. If the partnership operated in a unitary fashion with the Taxpayer, then the partnership's payroll, property, and sales factors would be included in the Taxpayer's Indiana adjusted gross income tax computations. If the operations were not unitary, the partnership's income will be allocated rather than apportioned.

The issue to be determined is if the partnership operated on a unitary basis with the Taxpayer during 2002.

[45 IAC 3.1-1-153](#)(b) states that for purposes of the Indiana Adjusted Gross Income Tax, unitary status is to be determined by the established standards. The U.S. Supreme Court set the standards for determination of unitary status in Container Corporation of America v. Franchise Tax Board, 463 U. S. 159 (1983). In that case, the Court set out a three-factor formula to use in a determination of whether two businesses operated in a unitary manner. Factor one is functional integration, factor two is centralization of management, and factor three is

economies of scale. Each of the factors must be met for a finding of unitary status among two business concerns.

The Taxpayer argued that the terrorist events of September 2001, resulted in radical changes and difficulties in the transportation industry. These changes and difficulties caused severe financial difficulties for the partnership. Consequently, the Taxpayer developed a unitary operation with the partnership in an attempt to reverse the partnership's financial losses stemming from the nation's post September 2001 economic environment.

The Taxpayer argued that factors of functional integration and economies of scale were fulfilled by the Taxpayer securing financing for the partnership. The Taxpayer acted as guarantor of the third party financing. The Taxpayer also performed a review to determine if the partnership's accounting functions should have been taken over by the Taxpayer. There is no evidence that the Taxpayer actually took over the partnership's accounting functions.

The Taxpayer argued that the actions of its Chairman of the Board fulfilled the requirements of the third factor, centralized management. The Taxpayer's Chairman of the Board determined which expenses the partnership was to cut and how much the cuts should be. He performed the review of the partnership's accounting functions. He also reviewed management decisions of the partnership until its sale in August of 2002.

The Container Corporation case concerns itself with the determination of unitary status between a parent and subsidiary corporations. In this situation, the Taxpayer was not the parent corporation. Rather, the Taxpayer was a limited partner in a partnership. Limited partners generally are investors and not considered to be operating in unitary status with the partnership. The Taxpayer purchased the interest in the limited partnership as the typical limited partner, an investor. As a limited partner, the Taxpayer generally would have little role in the management and operation of the partnership. There would have to be an extraordinary integration of the management, function, and economies of scale factors for the two concerns to exhibit a unitary status. The Taxpayer failed to sustain its burden of proving that the necessary level of extraordinary integration existed in this situation. Here the Taxpayer acted in the manner of a prudent limited partner attempting to protect an investment.

FINDING

The Taxpayer's protest is respectfully denied.

II. Tax Administration- Ten Percent Negligence Penalty

DISCUSSION

The Taxpayer also protested the imposition of the ten percent negligence penalty pursuant to IC § 6-8.1-10-2.1. Indiana Regulation [45 IAC 15-11-2](#)(b) clarifies the standard for the imposition of the negligence penalty as follows:

Negligence, on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The standard for waiving the negligence penalty is given at [45 IAC 15-11-2](#)(c) as follows:

The department shall waive the negligence penalty imposed under [IC 6-8.1-10-1](#) if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

- (1) the nature of the tax involved;
- (2) judicial precedents set by Indiana courts;
- (3) judicial precedents established in jurisdictions outside Indiana;
- (4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc;
- (5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

The Taxpayer provided substantial documentation to indicate that its failure to pay the assessed tax was due to reasonable cause rather than negligence.

FINDING

The Taxpayer's protest is sustained.